

Message Text

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ACTION EUR-12

INFO OCT-01 EA-07 NEA-10 IO-13 ISO-00 SP-02 USIA-06 AID-05

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FM AMEMBASSY LONDON

TO TREASURY DEPT WASHDC

SECSTATE WASHDC 3827

INFO AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

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E.O. 11652: N/A

TAGS: EFIN, UK

SUBJECT: THE EXPENDITURE CUT DEBATE CONTINUES

REF: LONDON 10997

SUMMARY: THE CUTS IN NEXT YEAR'S PUBLIC EXPENDITURE PLANS, PREVIOUSLY HINTED AT BY THE PRIME MINISTER AND THE CHANCELLOR, ARE BEING LAID BEFORE THE CABINET THE PARLIAMENTARY LABOUR PARTY AND THE TRADES UNION CONGRESS. THEIR REACTIONS HAVE RANGED FROM ANGUISHED ACQUIESCENCE TO UNCONCEALED OUTRAGE. THE PROPOSED ONE BILLION POUNDS IN CUTS IS BEING JUSTIFIED ON THE GROUNDS THAT CURRENT GOVERNMENT SPENDING PLANS ARE NOT COMPATIBLE WITH A NON-INFLATIONARY RECOVERY AND A STABLE EXCHANGE RATE. REJECTING THE ALTERNATIVES PROPOSED BY THE PARLIAMENTARY LABOUR PARTY OF INCREASED TAXATION AND IMPORT CONTROLS, THE CHANCELLOR ARGUES FORCEFULLY THAT THE ECONOMIC COSTS OF THE CUTS ARE FAR LESS THAN THOSE OF THE ALTERNATIVES. INDIVIDUAL MEMBERS OF THE CABINET, FACED WITH H.M.TREASURY'S PROPOSED OUTLINE OF SIZE AND DISTRIBUTION OF THE CUTS, ARE ARGUING OVER THE MAGNITUDE OF CUTS FOR THEIR RESPECTIVE MINISTRIES. END SUMMARY.

1. SINCE THE PUBLICATION OF THE CURRENT PUBLIC EXPENDITURE WHITE PAPER LAST FEBRUARY. THE GOVERNMENT HAS EXPLICITLY RECOGNIZED THE NEED PROGRESSIVELY TO REDUCE THE PUBLIC SECTOR'S SLICE OF GROSS DOMESTIC PRODUCT OVER THE PERIOD 1977-80. THIS WAS A LOGICAL EXTENSION OF THE DECISION TO COMMIT RESOURCES TO IMPROVING THE UK'S INDUSTRIAL CAPACITY OVER THE MEDIUM-TERM. THE MARCH-MAY RUN ON STERLING COUPLED WITH THE STRONGER THAN ANTICIPATED ECONOMIC UPTURN HAVE INCREASED PRESSURES ON THE GOVERNMENT TO ANNOUNCE ACTUAL CUTS (RATHER THAN MERE REDUCTIONS IN THE RATE OF GROWTH) IN PLANNED SPENDING.

2. WHILE ABJURING ANY REDUCTIONS FOR THE CURRENT FISCAL YEAR, BOTH THE PRIME MINISTER AND THE CHANCELLOR CAREFULLY LEFT THE DOOR OPEN ON THE NEXT FISCAL YEAR. THE MASSIVE TRADE UNION RATIFICATION OF A SECOND YEAR OF WAGE RESTRAINT OBTAINED ON JUNE 16, BROUGHT WITH IT LOUDER AND LIMITED OFFICIAL USE

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MORE PERSISTENT PUBLIC HINTS OF EARLY CUTS. DURING THE PAST 2 WEEKS, THE CHANCELLOR. WITH THE APPROVAL OF THE PRIME MINISTER, PLACED A DETAILED LIST OF PROPOSED CUTS BEFORE THE CABINET. THE CHANCELLOR'S CASE APPEARS BASED ON THE FOLLOWING EXPECTATIONS:

REAL GROWTH IN GDP OF 5 PERCENT OVER THE NEXT 12 MOS.

A 15 PERCENT INCREASE IN THE VOLUME OF MANUFACTURING INVESTMENT OVER THE NEXT 12 MONTHS.

A 10 PERCENT INCREASE IN THE VOLUME OF EXPORTS.

AN 11.4 BILLION POUND PUBLIC SECTOR BORROWING REQUIREMENT, IE, A 500 MILLION REDUCTION DUE TO INCREASED ECONOMIC GROWTH.

IN HIS VIEW, THE DEMANDS ON AVAILABLE RESOURCES BY THE FIRST THREE WERE INCOMPATIBLE WITH THE FOURTH; I.E., A BORROWING REQUIREMENT OF THAT MAGNITUDE (11 PERCENT OF GDP) COULD ONLY BE FINANCED BY MEANS OF AN INFLATIONARY INCREASE IN THE MONEY SUPPLY OR, BARRING THAT, WOULD RESULT IN MUCH HIGHER INTEREST RATES THEREBY CHOKING OFF NEEDED INVESTMENT. HEALEY REJECTED THE ALTERNATIVE OF AN INCREASE IN TAXATION SINCE IT WOULD FURTHER REDUCE DISPOSABLE INCOME ALREADY SQUEEZED BY WAGE RESTRAINT. IMPORT CONTROLS WERE ALSO RULED OUT AS BEING COUNTER-PRODUCTIVE. THE ONLY FEASIBLE ALTERNATIVE IN MR. HEALEY'S VIEW WAS TO CUT PUBLIC EXPENDITURE.

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3. THE EXPENDITURE CUTS WOULD TAKE EFFECT IN THE 1977/78
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FISCAL YEAR BEGINNING APRIL 1, 1977. A LEVEL OF ONE BILLION POUNDS IS GENERALLY THOUGHT TO BE THE ORDER OF MAGNITUDE UNDER CONSIDERATION. SINCE SPENDING PLANS ALREADY PUBLISHED FOR NEXT YEAR CALL FOR TOTAL EXPENDITURE (EXCLUSIVE OF DEBT INTEREST AND CONTINGENCY FUNDS) OF 44.9 BILLION POUNDS (1975 SURVEY PRICES). THE CHANCELLOR IS CALLING FOR CUTS OF ABOUT 2.2 PERCENT IN REAL TERMS.

4. IT IS ALREADY KNOWN THAT WHILE NO DEPARTMENT WILL BE EXEMPT, THE CUTS WILL NOT BE OF UNIFORM DEPTH. THE AREAS WHICH ARE LIKELY TO BEAR A DISPROPORTIONATE SHARE ARE ROADS, TRANSPORT, HOUSING AND VARIOUS SUBSIDIES (FOOD, RENT). WITH THE EXCEPTION OF SUBSIDIES. THERE ARE PROGRAMS WITH A HIGH CAPITAL CONTENT WHERE CUTS WOULD BOTH REDUCE THE OVERALL DEFICIT AND INCREASE THE AVAILABILITY OF RESOURCES WHICH COULD MORE EASILY BE DIVERTED TO MANUFACTURING INVESTMENT.

5. THE CHANCELLOR HAS ESTIMATED THAT SOME 70,000 JOBS COULD BE ELIMINATED OVER THE NEXT 2 YEARS AS A RESULT OF THE CUTS. HOWEVER HE EXPECTS THAT THE CONTINUING UPTURN IN THE ECONOMY WILL MAKE REABSORPTION OF THIS LABOR A MANAGEABLE PROBLEM.

6. IN OVERALL TERMS. THE CUTS WILL REDUCE GOVERNMENT BORROWING BY ABOUT 10 PERCENT DURING THE 1977/78 FISCAL YEAR FROM ROUGHLY 10-11 BILLION POUND LEVEL WHICH SEEMS LIKELY ON THE BASIS OF UNCHANGED POLICIES.

7. WHAT IS AT ISSUE? TO MANY OBSERVERS. (INCLUDING THIS EMBASSY) IT SEEMS CLEAR THAT WITHOUT CUTS OF THIS MAGNITUDE OR EVEN SOMEWHAT MORE. THE IMPROVEMENT IN THE ECONOMIC ENVIRONMENT WHICH IS EVIDENT MAY COME TO A HALT AS THE GOVERNMENT HAS TO RELY INCREASINGLY ON INFLATIONARY FINANCING OF ITS BORROWING REQUIREMENT. THE UPTURN IN INVESTMENT SO CAREFULLY NURTURED, INCLUDING A RELAXATION OF THE PRICE CODE, 2 YEARS OF WAGE RESTRAINT, A COMMITMENT TO IMPROVING THE COMPETITIVE POSITION OF INDUSTRY WILL BE NIPPED IN THE BUD AS THE GOVERNMENT PRE-EMPTS LIMITED RESOURCES.

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8. A MAJOR UNCERTAINTY REMAINS: I.E., THE ACTUAL IMPACT OF THE CUTS ON THE ECONOMY AND THE REACTION OF THE FOREIGN EXCHANGE MARKETS. AT THE MOMENT, FAVORABLE REACTION TO THE CUTS APPEARS TO BE DISCOUNTED BY THE FOREIGN EXCHANGE MARKETS. SPENDING CUTS PROBABLY WILL NOT BRING ABOUT A FURTHER SHARP INCREASE IN STERLING. BUT RATHER WILL BE SEEN AS PROOF THAT THE GOVERNMENT CAN PUSH THROUGH TOUGH, NEEDED MEASURES TO HELP STABILIZE THE ECONOMY. THE DANGER TO STERLING WILL COME IF THE EXPECTED CUTS ARE NOT MADE.

ARMSTRONG

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